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Before the Subcommittee on Highways, Transit, and Pipelines
Committee on Transportation and Infrastructure
Hearing on Reliability of Highway Trust Fund Revenue Estimates

April 4, 2006

Mr. Chairman, Ranking Member DeFazio, and distinguished members of the Subcommittee, I appreciate the opportunity to discuss with you the Administration's forecast of highway-related excise taxes. I will focus my remarks on recent trends in these taxes, describe the methodology that underlies our forecast, and relate our forecasts over the past several years to actual receipts. I will also compare our forecast for the FY 2007 Budget to the forecast prepared by the Congressional Budget Office (CBO).

My testimony makes four main points:

- The Administration's forecast of highway-related excise taxes for the FY 2007 Budget is somewhat higher than the forecast for the FY 2006 Mid-Session Review, even after excluding the effects of the Surface Transportation Extension Act of 2005, Part V, with regard to the tax treatment of gasohol and related fuels (SAFETEA-LU).

- CBO's forecast of highway-related excise taxes is somewhat higher than the Administration's forecast, but the differences are not large, and are attributable to a number of factors, such as differences in underlying economic assumptions and methodology.

- All of these forecasts are well within what would be regarded as conventional confidence intervals for these estimates based on prior differences between forecasted receipts and actual receipts over the past decade and a half.

- Uncertainty in the forecast arises from a variety of factors, such as changing economic conditions, changes in energy markets and energy usage, and shifts in the relationship between economic variables and tax liabilities. The recent differences in estimates, whether comparing the Administration's FY 2006 Mid-Session Review and the FY 2007 Budget forecasts, or the Administration's and CBO's forecasts, may well be less important than the inherent uncertainty in these types of estimates.

Overview of Highway Related Excise Taxes

The Treasury Department's Office of Tax Analysis (OTA) is generally responsible for forecasting tax receipts for the President's Budget. The highway-related excise taxes are estimated using the Administration's economic forecast together with a wide range of economic models and recent data on tax collections and reported tax liabilities. The Administration's economic forecast is jointly formulated by the Troika, which consists of the Council of Economic Advisors, the Office of Management and Budget, and the Department of the Treasury. The Administration's economic forecast is used in conjunction with separate models for each of the five dedicated Highway Account excise tax sources: (i) Gasoline and related fuels, (ii) Diesel and other fuels, (iii) Trucks, (iv) Highway-type tires, and (v) Heavy vehicles. The Administration's forecast and recent historical data on actual tax receipts for each of these five excise taxes are provided in Tables 1 and 2.[1]

Highway-related excise taxes have grown in the past year from $29.8 billion to $32.9 billion, an increase of 10.5 percent. Most of this growth is attributable to statutory changes made to the gasoline tax, the largest of the highway-related excise taxes, under the Surface Transportation Extension Act of 2004, Part V (Public Law 108-357). This Act changed the tax treatment of gasohol and related fuels. The tax on diesel fuel and the retail tax on trucks also contributed to the growth in highway-related excise taxes, reflecting the recent strength in the economy, increased product shipments, higher equipment investment, and a recovery of the heavy truck market.

The balance and overall health of the Highway Trust Fund depends on both incoming receipts and outgoing disbursements. Treasury is responsible for collecting and reporting tax receipts and forecasting future tax receipts. The Department of Transportation is in the best position to respond to questions concerning disbursements from the Highway Trust Fund to meet the various obligations. Nevertheless, according to Administration estimates, the highway account will be exhausted by 2009 (i.e., the highway account will have a negative cash balance of $2.3 billion at the end of 2009). CBO estimates indicate the highway account will be exhausted one year later. The difference in the timing of when the highway account is exhausted is due to differences in the Administration's and CBO's receipt forecasts. I will discuss the Administration's estimates and how they relate to CBO's.

[1] The 2000 through 2005 figures are actual receipts drawn from the Highway Trust Fund Income Statement while the 2006 through 2011 figures are projections from the President's FY 2007 Budget.

How Receipts Get to the Highway Trust Fund

Highway-related excise taxes are deposited to the Highway Trust Fund and other trust funds established in the Internal Revenue Code in a multi-step process starting with estimated tax payments made to the Internal Revenue Service (IRS), allocations to the trust funds made by OTA, the filing of excise tax returns by taxpayers, and a final certification of the trust funds by the IRS.

The process begins when motor fuel, which accounts for more than 90 percent of trust fund receipts, is taxed as it moves out of the bulk transportation and storage network and into tanker trucks at the terminal rack. The fuel is taxed or it is dyed if it is diesel or kerosene intended for nontaxable purposes. The owner of the fuel, the registered position holder, is liable for payment of the tax as it passes the terminal rack. Taxpayers with more than $2,500 in net excise tax liability are required to make semi-monthly estimated payments and typically rely on safe harbor rules in determining the amount to deposit.[2] These deposits are typically made via the Electronic Federal Tax Payment System and are initially deposited in the Treasury's General Fund.

Taxpayers are not required to itemize which excise taxes they are depositing. Taxpayers simply indicate that the payment is for excise taxes, which can be for any of the approximately 50 different excise taxes. Even taxpayers that exclusively owe taxes on motor fuel are likely to have tax liability for a combination of gasoline, diesel, kerosene, and possibly various alternative fuels. These fuels are taxed at different rates and distributed in different proportions to the Highway Trust Fund and the Leaking Underground Storage Tank Trust Fund. Estimates of allocations to the trust funds are needed because the initial deposits are not distinguished by type of excise tax.

The OTA is required by Section 9601 of the Internal Revenue Code to estimate and allocate excise tax receipts to the Highway Trust Fund and other trust funds established in chapter 98 of the Internal Revenue Code. The semi-monthly transfers made by OTA to the trust funds are estimates based on the historical allocation of the excise taxes to the trust funds.

The quarterly excise tax returns filed by taxpayers serve as the basis for a final reconciliation and certification of the excise taxes to the trust funds. Taxpayers report and itemize most excise taxes quarterly on Form 720, due one month following the close of the quarter. For example, taxpayers report on Form 720 the number of gallons of each type of fuel and the tax due, and claims of nontaxable use of the fuel. Any balance due or overpayment is also settled when the Form 720 is filed. Liability for the heavy vehicle use tax is reported on Form 2290 and the liability must be paid in full with the return.

The IRS uses the Form 720 and Form 2290 returns, together with taxpayer payment records, to calculate the Highway Trust Fund Certification of taxes collected for the quarter. After processing an excise tax return, the IRS compares the reported tax liability with the deposits received from a taxpayer. In cases where taxpayers have reported tax liability exceeding their deposits, deposits are allocated based on their prorated reported liability to assure that certified amounts equal tax collections. On the quarterly certification, IRS reports the total prorated

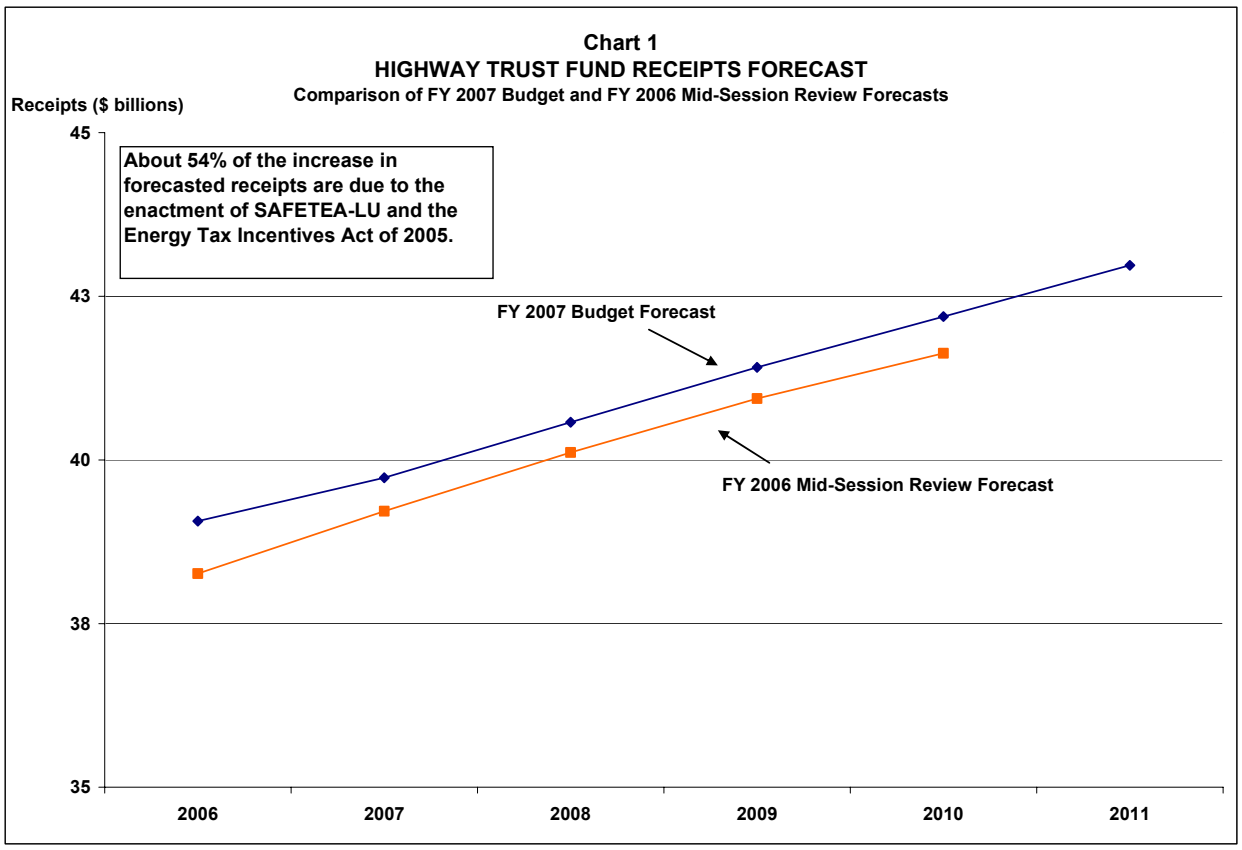
[2] For example, safe harbor rules permit taxpayers to make deposits of one-sixth of their tax liability from the quarter that occurred two quarters prior to the current quarter.

liability for the quarter. In order to allow time for late filing by taxpayers, amended returns, or adjustments from examinations, the certification is issued approximately four and a half months following the due date of the return. The certified amount is then compared to the amounts transferred by OTA and the IRS makes reconciling adjustments to the trust fund accounts for differences between the certified amounts and the amounts previously transferred.

Forecast of Future Excise Tax Receipts

OTA uses a set of models to estimate the tax receipts dedicated to the Highway Trust Fund. Each of the models estimates the historic relationship between macroeconomic variables from the Administration's economic forecast and excise tax liability. The general structure of the models draw on relationships reported in the economics literature and include macroeconomic variables such as real gross domestic product (GDP) and oil prices to establish the historic relationship between tax liability and the economic variables. The estimated relationship from these models is then used with the Administration's economic assumptions to project tax liability over the budget period. OTA also uses recent tax collection data to further calibrate and adjust the models. Each of the models is continually evaluated in the light of new economic research and data.

The Administration's forecasts from the Fiscal Year 2006 Mid-Session Review and the Fiscal Year 2007 Budget are compared in chart 1 (see below). As illustrated, the forecast of receipts dedicated to the Highway Trust Fund over the budget period increased from the FY 2006 Mid-Session Review to the FY 2007 Budget . The increase is due to both enacted legislation (54 percent) and technical and economic changes (46 percent). Changes in the Administration's forecast of real GDP, oil prices and several other macroeconomic variables explain the economic changes. The technical changes primarily reflect OTA's recalibration of the models to recent tax collection data and refinements to the models used to project tax liability.

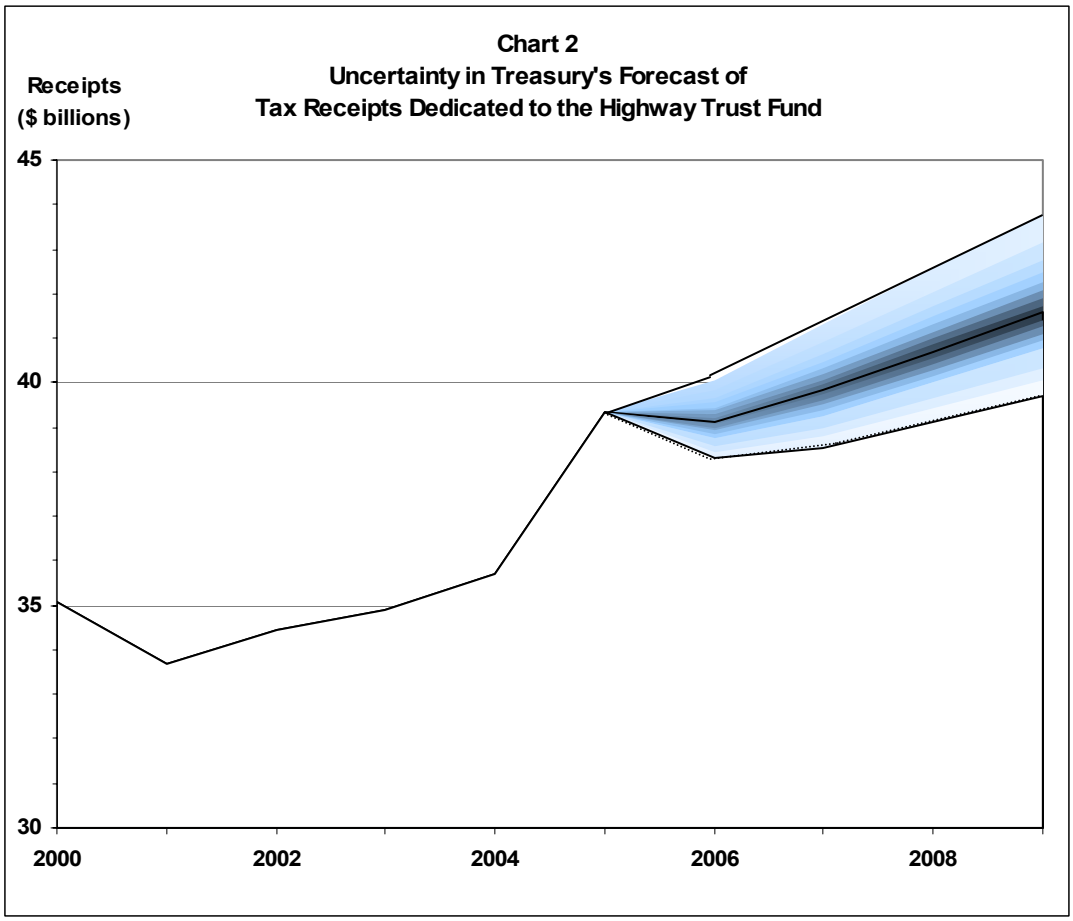


As depicted in Chart 1, the Administration projects steady growth in highway-related excise tax receipts. Net receipts in FY 2006 are projected to increase by 3.1 percent as compared to FY 2005. Average annual growth is forecast to be 2.3 percent annually through 2009, slightly above the 2.2 percent average annual growth forecast for the FY 2006 Budget. In the FY 2007 Budget, the Administration forecasts net Highway Account excise tax receipts to be $39.1 billion in FY 2006 and $41.4 billion in 2009.

From 2006 through 2009, gallons of gasoline and gasohol fuels consumed are projected to grow at an average of 2.1 percent per year (net of the statutory change in the treatment of gasohol fuels). For the same period, gallons of diesel and related fuels consumed are projected to grow at an average of 1.7 percent per year. The truck related excise tax receipts are projected to grow more quickly than fuel receipts. From 2006 to 2009, receipts from the retail tax on trucks, the tax on highway type tires, and the heavy vehicle use tax are projected to grow at an average of 5.3 percent, 6.2 percent, and 4.2 percent per year, respectively.

OTA's estimates represent our best estimates based on the Administration's economic assumptions and our underlying models. To provide some perspective for how well our forecasts predict actual tax receipts, we have analyzed the difference or deviation between prior forecasts of receipts and actual receipts. From these deviations, we have constructed confidence intervals around our current forecast shown in Chart 2 (see below) to indicate the uncertainty of our estimates.

The confidence intervals were constructed based on a statistical analysis of Treasury's historical forecasting errors from 1995 to 2005.[3] The size of the confidence intervals widens over the projection period reflecting the greater uncertainty over time. Given past experience, no changes in the tax law, and the current baseline forecast, FY 09 receipts are expected, with 90 percent confidence, to be between $39.0 billion and $43.8 billion (with the most likely outcome to be $41.4 billion).



Comparison of Congressional Budget Office and Office of Tax Analysis Forecasts

Over the FY 2006 – FY 2009 period, CBO projects that excise tax receipts deposited to the Highway Trust Fund will total $167.2 billion. OTA projects that excise tax receipts deposited to the Highway Trust Fund for the same period will total $160.8 billion; a difference of $6.4 billion or 4 percent with the CBO forecast. CBO projects that excise tax deposits to the Highway Account of the Highway Trust Fund will exceed amounts forecast by OTA by about 4 percent, or $5.4 billion. The largest excise tax sources dedicated to the Highway Trust Fund, the excise tax on gasoline and diesel fuels and trucks, account for most of the difference in these projections.

While OTA and CBO generally use a similar methodology to estimate receipts dedicated to the Highway Trust Fund, several factors explain the differences in the most recent baselines.

[3] Basing the confidence intervals on past experience, of course, presumes that future errors will be similar to past errors. Forecasts with the greatest likelihood are those closest to the time of the receipts forecast.

Differences in the economic assumptions used by CBO and OTA in preparing their respective forecasts of Highway Trust Fund excise taxes account for part of the difference in revenue projections. The major economic drivers of the forecasting models of excise taxes dedicated to the Highway Trust Fund used by CBO and OTA are GDP growth and oil prices. Higher economic growth translates into higher overall receipts, while higher oil prices lower overall receipts. Currently, the Administration is forecasting somewhat slower economic growth and lower oil prices than CBO through the FY 2006 – FY 2009 budget period.

The impact of the differences between CBO's and the Administration's economic assumptions on the receipts forecasts also depends on the relative responsiveness of the models to the forecasts of real GDP growth and oil prices.[4] In projecting diesel fuel consumption, OTA's model tends to be more sensitive to changes in oil prices than CBO's, while CBO's model is more responsive to real GDP growth than OTA's. On net, the differences in economic assumptions used by CBO and OTA combined with the greater sensitivity to oil prices in the OTA model cause the Administration's forecast of diesel fuel excise taxes to be somewhat lower than CBO's. CBO and OTA have an open dialogue regarding this model. The differences in the model reflect different choices and judgments by the two organizations.

In projecting gasoline and gasohol consumption, both OTA and CBO incorporate income and price effects. Both incorporate responses of fuel consumption to prices in the short term, as people drive fewer miles, and in the longer-term, as people purchase more fuel-efficient vehicles. However, OTA assumes a larger response to prices in the longer term than CBO, and OTA assumes a relatively lower response to income than CBO. Thus, compared with OTA's model, CBO's model puts greater weight on the revenue-increasing effects of projected higher incomes and less weight on the revenue-decreasing effects of recent increases in oil prices. The net result of the interaction between the "economic" and "technical" (modeling) differences between CBO and OTA's forecasting models is higher CBO forecasts of gasoline and gasohol excise taxes that diverge over the FY 2006 – FY 2009 Budget period.

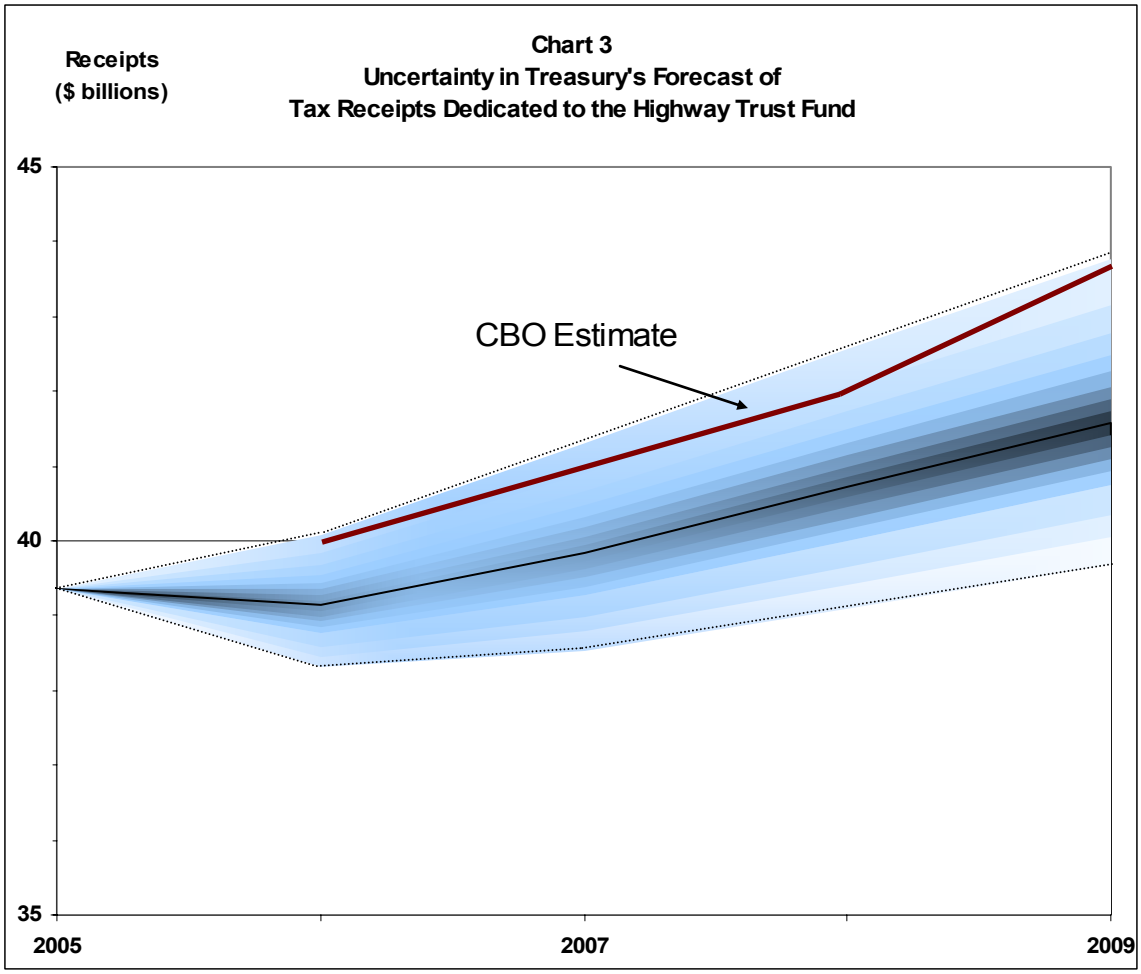
Discussions between OTA and CBO have revealed that there are other technical modeling differences between the two offices that also contribute to the difference in forecasts of excise tax deposits to the Highway Trust Fund. CBO and OTA use different variables to forecast gasoline, gasohol, and diesel fuel consumption and use different historical periods to estimate their models. In both the gasoline and gasohol model and the diesel model, OTA uses the price of crude oil in a model of consumption after accounting for state and federal taxes. Also, in the model used to establish the historical relationship between taxes and the macroeconomic variables, OTA uses tax liability updated by the IRS to account for when taxes are accrued as opposed to processed.[5] Tax liability defined on an accrual basis will be more directly related to the underlying economic activity determining fuel consumption and rely on a more accurate depiction of seasonal behavior and trends. OTA and CBO also make different assumptions regarding future fuel efficiency of the vehicle fleet. While these differences exist, the assumptions used by both CBO and OTA are consistent with the range of results cited in the

[4] In addition to different modeling assumptions about the responsiveness of Highway Trust Fund excise taxes to GDP growth and oil price changes, differences in assumptions made regarding the timing of tax payments with respect to recent liability years can impact forecasts of excise tax deposits to the Highway Trust Fund. In the short-run, the difference in the "base" year of the forecast causes CBO's projection to be higher than OTA's throughout the projection period.

[5] These data are reported to OTA monthly in the Treasury-92 Supplemental Report.

economic literature and, as shown in Chart 3 (see below), produce estimates that are close when viewed from the perspective of historical deviations in the forecasts and the corresponding confidence intervals.

In contrast to fuel taxes, OTA forecasts higher excise taxes on the sale of retail trucks than CBO (by $0.9 billion over the FY 2006 – FY 2009 period.) The Administration's and CBO's economic forecasts of equipment investment are similar during this period, thus the differences are largely technical in nature.



In summary, the Administration's forecast of highway-related excise taxes have increased since the FY 2006 Mid-Session Review, reflecting the enactment of SAFETEA-LU and the Energy Tax Incentives Act of 2005, changes in underlying economic conditions, and refinements to our methodology. Although there are differences between OTA's and CBO's forecasts, these are reflective of differences in the economic outlook and minor differences in the underlying methodology. An analysis of historical deviations between OTA's forecasts and actual tax receipts indicates that the differences between the Administration's forecast and CBO's both fall within the 90 percent confidence interval. This indicates that each forecast is just as likely to occur 90 percent of the time, thus suggesting that the differences are not statistically material.

As in the past, OTA and CBO continue to work closely to understand differences between the models, and incorporate new research and data into the forecasts.

Conclusion

I thank you for the opportunity to testify before the Committee today and look forward to your questions.

Table 1
Forecast Excise Tax Receipts to the Highway Account of the Highway Trust Fund

	Actual 2000	Actual 2001	Actual 2002	Actual 2003	Actual 2004	Actual 2005	Forecast 2006	Forecast 2007	Forecast 2008	Forecast 2009	Forecast 2010	Forecast 2011
Highway Account												
Gross Transfers												
Gasoline	19,262	18,441	19,273	19,600	19,929	21,181	22,038	22,361	22,696	23,027	23,337	23,628
Diesel & other fuels	7,427	7,158	7,366	7,531	7,883	8,426	8,558	8,631	8,817	9,000	9,148	9,299
Retail tax on Trucks	3,321	1,489	1,266	1,710	1,847	2,993	3,128	3,287	3,487	3,679	3,864	4,075
Highway-type tires	442	343	351	403	446	467	560	556	569	587	607	629
Heavy vehicle use tax	921	610	982	940	945	1,090	1,094	1,155	1,217	1,282	1,351	1,422
Gross HA Transfers	31,373	28,041	29,238	30,184	31,050	34,157	35,378	35,990	36,786	37,575	38,307	39,053
Less Aquatic Resources	209	215	353	360	373	383	371	380	391	402	412	423
Net HA Transfers	31,164	27,826	28,885	29,824	30,677	33,774	35,007	35,610	36,395	37,173	37,895	38,630
Less HA Refunds	831	925	919	878	908	880	956	965	984	1,005	1,024	1,044
Net Highway Account Receipts	**30,333**	**26,901**	**27,966**	**28,946**	**29,769**	**32,894**	**34,051**	**34,645**	**35,411**	**36,168**	**36,871**	**37,586**
Year-to-Year Changes												
Gross Transfers												
Gasoline		-821	832	327	329	1,252	857	323	335	331	310	291
Diesel & other fuels		-269	208	165	352	543	132	73	186	183	148	151
Retail tax on Trucks		-1,832	-223	444	137	1,146	135	159	200	192	185	211
Highway-type tires		-99	8	52	43	21	93	-4	13	18	20	22
Heavy vehicle use tax		-311	372	-42	5	145	4	61	62	65	69	71
Gross HA Transfers		-3,332	1,197	946	866	3,107	1,221	612	796	789	732	746
Less Aquatic Resources		6	138	7	13	10	-12	9	11	11	10	11
Net HA Transfers		-3,338	1,059	939	853	3,097	1,233	603	785	778	722	735
Less HA Refunds		94	-6	-41	30	-28	76	9	19	21	19	20
Net Highway Account Receipts		**-3,432**	**1,065**	**980**	**823**	**3,125**	**1,157**	**594**	**766**	**757**	**703**	**715**
Year-to-Year Percentage Changes												
Gross Transfers												
Gasoline		-4.3%	4.5%	1.7%	1.7%	6.3%	4.0%	1.5%	1.5%	1.5%	1.3%	1.2%
Diesel & other fuels		-3.6%	2.9%	2.2%	4.7%	6.9%	1.6%	0.9%	2.2%	2.1%	1.6%	1.7%
Retail tax on Trucks		-55.2%	-15.0%	35.1%	8.0%	62.0%	4.5%	5.1%	6.1%	5.5%	5.0%	5.5%
Highway-type tires		-22.4%	2.3%	14.8%	10.7%	4.7%	19.9%	-0.7%	2.3%	3.2%	3.4%	3.6%
Heavy vehicle use tax		-33.8%	61.0%	-4.3%	0.5%	15.3%	0.4%	5.6%	5.4%	5.3%	5.4%	5.3%
Gross HA Transfers		-10.6%	4.3%	3.2%	2.9%	10.0%	3.6%	1.7%	2.2%	2.1%	1.9%	1.9%
Less Aquatic Resources		2.9%	64.2%	2.0%	3.6%	2.7%	-3.1%	2.4%	2.9%	2.8%	2.5%	2.7%
Net HA Transfers		-10.7%	3.8%	3.3%	2.9%	10.1%	3.7%	1.7%	2.2%	2.1%	1.9%	1.9%
Less HA Refunds		11.3%	-0.6%	-4.5%	3.4%	-3.1%	8.6%	0.9%	2.0%	2.1%	1.9%	2.0%
Net Highway Account Receipts		**-11.3%**	**4.0%**	**3.5%**	**2.8%**	**10.5%**	**3.5%**	**1.7%**	**2.2%**	**2.1%**	**1.9%**	**1.9%**

Note: The FY 2000 through FY2005 figures are based on the end-of-year Highway Account Income Statement reported by the Bureau of Public Debt. The FY 2006 through FY 2011 figures are forecasts made by the Office of Tax Analysis, Department of the Treasury for the FY 2007 Budget.

Table 2
Forecast Excise Tax Receipts to the Mass Transit Account of the Highway Trust Fund

	Actual 2000	Actual 2001	Actual 2002	Actual 2003	Actual 2004	Actual 2005	Forecast 2006	Forecast 2007	Forecast 2008	Forecast 2009	Forecast 2010	Forecast 2011
Mass Transit Account												
Gross Transfers												
Gasoline	3,844	3,696	3,844	3,960	4,031	4,037	4,064	4,124	4,186	4,247	4,304	4,358
Diesel & other fuels	956	957	965	1,021	1,052	1,126	1,144	1,155	1,180	1,205	1,225	1,245
Gross MTA Transfers	4,800	4,653	4,809	4,981	5,083	5,163	5,208	5,279	5,366	5,452	5,529	5,603
Less Aquatic Resources	28	29	33	35	38	39	51	53	54	56	58	60
Net MTA Transfers	4,772	4,624	4,776	4,946	5,045	5,124	5,157	5,226	5,312	5,396	5,471	5,543
Less MTA Refunds	69	70	127	136	106	126	142	144	147	149	152	155
Net MTA Receipts	**4,703**	**4,554**	**4,648**	**4,810**	**4,939**	**4,998**	**5,015**	**5,082**	**5,165**	**5,247**	**5,319**	**5,388**
Year-to-Year Changes												
Gross Transfers												
Gasoline		-148	148	116	71	6	27	60	62	61	57	54
Diesel & other fuels		1	8	56	31	74	18	11	25	25	20	20
Gross MTA Transfers		-147	156	172	102	80	45	71	87	86	77	74
Less Aquatic Resources		1	4	2	3	1	12	2	1	2	2	2
Net MTA Transfers		-148	152	170	99	79	33	69	86	84	75	72
Less MTA Refunds		1	57	9	-30	20	16	2	3	2	3	3
Net MTA Receipts		**-149**	**94**	**162**	**129**	**59**	**17**	**67**	**83**	**82**	**72**	**69**
Year-to-Year Percentage Changes												
Gross Transfers												
Gasoline		-3.9%	4.0%	3.0%	1.8%	0.1%	0.7%	1.5%	1.5%	1.5%	1.3%	1.3%
Diesel & other fuels		0.1%	0.8%	5.8%	3.0%	7.0%	1.6%	1.0%	2.2%	2.1%	1.7%	1.6%
Gross MTA Transfers		-3.1%	3.4%	3.6%	2.0%	1.6%	0.9%	1.4%	1.6%	1.6%	1.4%	1.3%
Less Aquatic Resources		3.6%	13.8%	6.0%	8.6%	2.6%	30.8%	3.9%	1.9%	3.7%	3.6%	3.4%
Net MTA Transfers		-3.1%	3.3%	3.6%	2.0%	1.6%	0.6%	1.3%	1.6%	1.6%	1.4%	1.3%
Less MTA Refunds		1.4%	81.4%	7.1%	-22.1%	18.9%	12.7%	1.4%	2.1%	1.4%	2.0%	2.0%
Net MTA Receipts		**-1.6%**	**2.1%**	**3.5%**	**2.7%**	**1.2%**	**0.3%**	**1.3%**	**1.6%**	**1.6%**	**1.4%**	**1.3%**

Note: The FY 2000 through FY2005 figures are based on the end-of-year Highway Account Income Statement reported by the Bureau of Public Debt. The FY 2006 through FY 2011 figures are forecasts made by the Office of Tax Analysis, Department of the Treasury for the FY 2007 Budget.